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Canada

Dairy and Products Annual

Approved By:
Jeff Zimmerman

Prepared By:
Darlene Dessureault

Report Highlights:
Due to the supply management system in place, significant changes in milk production from year to year due to changing international market conditions do not occur. Milk production in 2014 is forecast to fall slightly to bring milk production back in line with the requirements of the industrial and fluid milk markets. Butter, and cheese production is forecast to fall slightly in 2014 as a result of strong stocks. Skim milk powder production is forecast to fall in response to a forecast slowdown in butter production. Changes in domestic policy occurred in 2013 in order for domestic restaurants which serve pizza to become more competitive with the frozen pizza industry. Canada and the European Union (EU) announced an agreement in principle for the Comprehensive Economic Trade Agreement (CETA) which included a broadening of access for E.U. cheese. Canada's use of its classified milk pricing system and the manner in which support is notified at the World Trade Organization (WTO) continued to be questioned at the WTO Committee on Agriculture.

Executive Summary:

In 2012, dairy production in Canada generated total net farm receipts of $US 5.9 billion, up $US 0.1 billion from the previous year, and generated sales of $US 14.7 billion, representing 16.4 percent of the Canadian food and beverage sector. The dairy industry ranks third in terms of value in the Canadian agricultural sector following grains and red meat (http://www.dairyinfo.gc.ca/index_e.php?s1=cdi-ilc).

Due to the supply management system in place, significant changes in milk production from year to year due to changing international market conditions do not occur. Milk production in 2014 is forecast to fall slightly to bring milk production back in line with the requirements of the industrial and fluid milk markets.

Total cheese production in 2013 is estimated to remain the same in 2013 but is forecast to fall slightly in 2014 due to strong stocks.

After climbing to a production level of 98.0 TMT in 2012, the highest production level since 1990, total butter production is expected to fall to 92.0 TMT in 2013, and is forecast to fall to more average production levels of 88 MT in 2014. The production increase in 2012 was due to the need to rebuild low stocks due to production lagging behind the quota. In 2013, butter production is expected to remain higher than average due to milk production exceeding industrial requirements.

Skim milk powder production drop further to 76 TMT in 2014 as a result of a forecasted continued slowdown in butter production.

While representing about one percent of total dairy output, organic milk production is steadily increasing in Canada, reaching close to 93.7 million liters in the 2010/2011 dairy year, up 4 percent from the previous year. The most popular finished organic dairy products remain yogurt, ice-cream and cheese.

Per capita milk consumption across all milk categories has decreased or remained the same, with skim milk showing the greatest decrease of 4% over the previous year's level. This is part of a long term trend that points to decreased consumption per capita.

Per capita domestic cheese consumption fell slightly or remained the same across all cheese categories (cheese, specialty, cottage). In recent years, per capita cheese consumption has been growing incrementally, due in part to increase usage of cheddar cheese in processed products, as well as an increasing popularity of artisanal cheeses.

The marginal increases in butter consumption in 2011 and 2012 are reflective of increased use of butter as an industrial input for products that are consumed in Canada and an increase in demand for butter under the Import for Re-Export Program (IREP) for use in further processing.

Domestic consumption of skim milk powder fell in 2012 to 69 TMT from 74 TMT in 2011. The Canadian Dairy Commission has been working hard to develop new uses and markets for the surplus powder.

In the spring of 2013, amendments were made to the Harmonized Milk Classification System. A new cheese class (3(d)) is for mozzarella cheese and provides a price discount to dairy processers to produce a cheaper mozzarella to be used by restaurants in making fresh pizza. The price differential between the new cheese class and the cheese available to further processors who manufacture frozen pizzas remains significant.

The 2002 ruling by the World Trade Organization (WTO) capped subsidized exports of dairy products from Canada. As a result, Canadian dairy producers are limited in the quantity of dairy products that can be exported from Canada and this has resulted in a negative trade balance in dairy products. For 2012, the Canadian dairy trade balance remained at a deficit of $US 440 million.

According to Agriculture and Agri-Food Canada, in 2012, the value of imports for all dairy products increased by 1% over 2011 levels to reach $US 677 million. In 2012, imports for all dairy products under the IREP increased by 2% to 55.6 TMT, driven by lower world prices. Imports are expected to follow similar trends in 2013 and 2014.

In 2012, Canadian dairy exports showed a 6 percent annual decrease to $US 237.4 million. The main products exported by Canada in 2012 were cheese, ice cream, whey, and skim milk powder. These represent 19.3 percent, 16.3 percent, and 13.9 percent respectively, share of total exports (value basis).

Total butter exports in 2013 will increase significantly over 2012 levels due mainly to a need to get rid of surplus butter in the system. This level of export is still within WTO allowable limits and Canada is also still respecting its outlay commitment level of $US 31 million dollars. Butter exports under HS code 040510 are headed to Turkey, Egypt and Morocco. Total butter exports (04051000, 040590, and 040520) for calendar year 2013 are expected to reach 5 TMT in 2013 and then fall to 3 TMT in 2014 as butter production slows and there is less surplus butter in the system.

On October 18, 2013, Canada announced that it had reached an agreement in principle with the European Union. The EU has been granted concessions on dairy that will more than double its current access level.

Details of the enforcement of geographical indications are unknown at this time. The list includes a number of cheeses, a few of which are matters of significant concern to the Canadian dairy industry, as well as U.S. industry.

Canada's use of its classified milk pricing system and the manner in which support is notified at the WTO continues to be question at the WTO Committee on Agriculture.

Canada’s supply management system continues to come under pressure due to increasing pressure from trade partners, a positive market environment, and the general movement towards freer markets.

The Canadian Dairy Industry at a Glance:

The Canadian dairy sector functions under a supply management system, based on planned domestic production, administered pricing and dairy product import controls.

In 2012, dairy production in Canada generated total net farm receipts of $US 5.9 billion, up $US 0.1 billion from the previous year, and generated sales of $14.7 billion, representing 16.4 percent of the Canadian food and beverage sector. The dairy industry ranks third in terms of value in the Canadian agricultural sector following grains and red meat (http://www.dairyinfo.gc.ca/index_e.php?s1=cdi-ilc).

The Farm:

Since 1999, the national dairy herd has declined by 17 percent, while total milk production has increased by two percent; these adjustments reflect ongoing restructuring at the farm level. Since 1999, the number of cows per farm has risen by over 30 percent and the average Canadian dairy farm now has 77 cows. Better feeding, disease control and genetic advancements have increased the amount of milk produced per cow. The Canadian dairy cattle population totals approximately 1.4 million and will likely remain constant.

The typical Canadian dairy farm is quite specialized, with most of its revenue coming from milk production and the sale of dairy cattle. It is a family-owned operation. The farm owners are in their mid-forties and have built up considerable equity in their operation. The typical family farm is accustomed to using advanced technology in practices such as artificial insemination, breed selection and labor-saving milking systems. Computerization of feeding and herd management systems, and equipment innovations are also rapidly changing the way things are done on the farm. The industry has experienced a 36 percent decline in the number of dairy farms over the past decade. However, individual farming units have grown in size and have become more effective in operation.

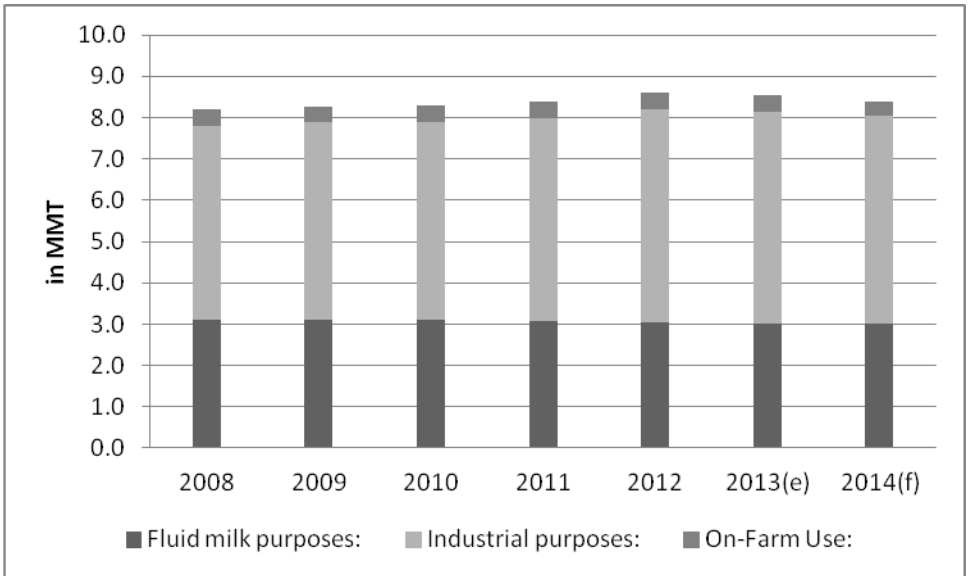
The dairy processing sector is relatively concentrated. Today, 14 percent of Canadian plants are owned by the three largest processors in the country (Saputo, Agropur and Parmalat), processing approximately 75 percent of the milk produced in Canada. The fluid milk market represents almost 40 percent of milk utilization, while the market for manufactured dairy products such as butter, cheese, yogurt and ice cream accounts for more than 60 percent of utilization.

Production:

Milk

In Canada, provincial milk marketing boards maintain responsibility for setting production limits of its own fluid milk, pricing formulas, quota policies and other regulations. Industrial milk production levels are allocated using a national management tool called the Market Sharing Quota (MSQ). Quota is allocated on a butterfat basis. It is set by the Canadian Milk Supply Management Committee (CMSMC), which applies the terms of the National Milk Marketing Plan (a federal-provincial agreement) to establish each province's share of the MSQ. The provinces are then responsible for distributing shares of the quota to producers according to provincial policies and in accordance with pooling agreements.

Figure 1: Milk Production in Canada, 2008-2014(f)



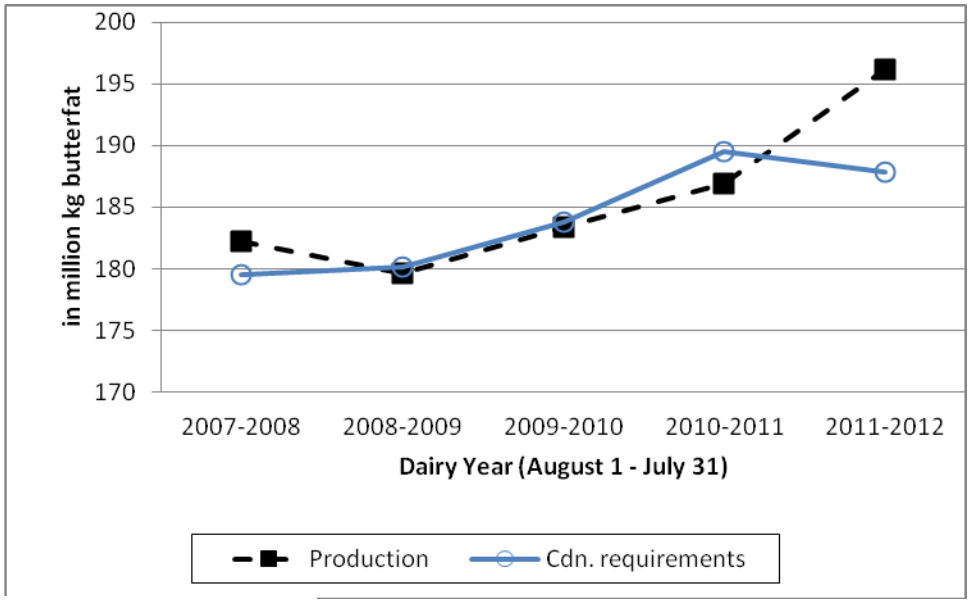
Source: Statistics Canada, Milk production and utilization, http://www5.statcan.gc.ca/cansim/pick-choisir?lang=eng&p2=33&id=0030011

Milk production in Canada supplies two markets. The fluid milk market includes creams and flavored milks. The industrial milk market is milk used to make products such as butter, cheese, yogurt, ice cream and milk powders. In 2012, the fluid milk market accounted for 37 percent of total milk produced in Canada, and the industrial milk market 59%. On farm use is estimated to account for approximately 4 to 5 percent of total milk produced.

The CMSMC sets the MSQ based on the recommendations of the Canadian Dairy Commission (CDC). The CDC monitors the trends in Canadian dairy requirements (demand) and makes recommendations on the necessary adjustments to reflect changes in demand for milk for industrial dairy products. ***Figure 2***, on the following page illustrates the changes in Canadian dairy requirements and milk production for industrial purposes over time by dairy year.

Due to the supply management system in place, significant changes in milk production from year to year due to changing international market conditions do not occur. Based on 8 months of production data of milk produced for the fluid milk market and for the industrial milk market, the estimate for total milk production for calendar year 2013 (including on farm feed use) is 8.536 million metric tons (MMT). This is generally unchanged from year 2012 levels. Milk production in the last 2 calendar years has been above the estimated dairy requirements due to the high quality of forage that has been available, as well as good weather conditions. Milk production in 2014 is expected to fall slightly to bring milk production back in line with the requirements of the industrial and fluid milk markets.

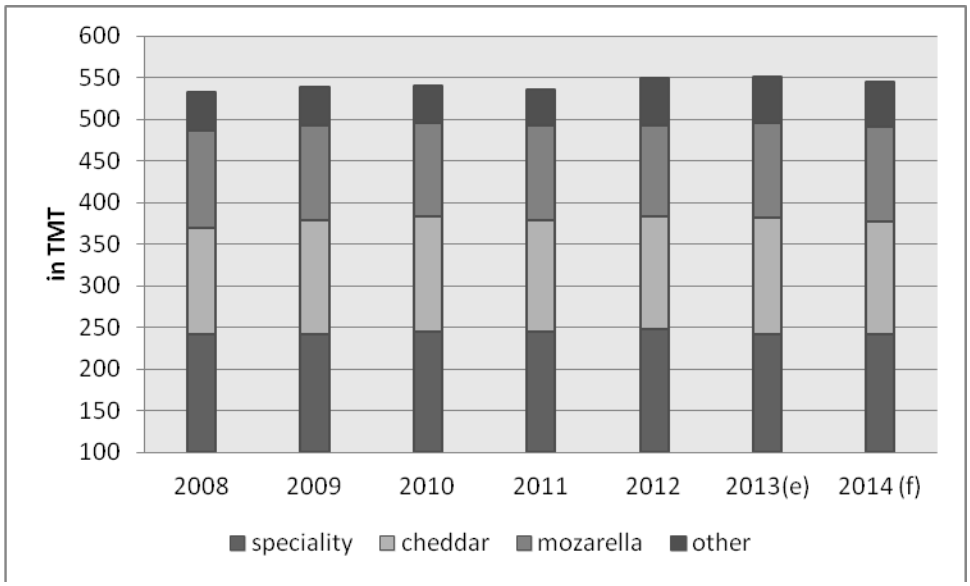
Figure 2: Canadian Dairy Requirements and Production for Industrial Milk Market



Source: Canadian Dairy Commission;
www.cdc-ccl.gc.ca/CDC/index-eng.php?id=3807

Cheese

Figure 3: Cheese Production in Canada, 2008-2014(f)



Source: Statistics Canada, Production of selected products, by dairy manufacturers– Cheese
http://www5.statcan.gc.ca/cansim/pick-choisir?lang=eng&p2=33&id=0030010

Based on 8 months of production data, increases in cheddar and mozzarella production above the previous year's level are expected to be offset by decreases in the production of specialty cheeses. Total cheese production in 2013 is estimated to reach 550 TMT, the same level of production attained in 2012 levels. Cheese production has been adjusted to exclude fresh cheeses such as ricotta, cream cheese,

cottage cheese, however specialty cheese have been included. The production of specialty cheeses, cheddar cheese and mozzarella cheeses together account for close to 90% of all cheese production. Cheddar cheese accounts for 25% of cheese production, mozzarella accounts for 21%, specialty cheeses account for 44% (this includes cheddar for further processing, and all other cheeses account for 10% of total cheese production. The light upward trend seen in cheese production since 2009 is due to stronger retail sales resulting from a recovering economy, and an increased usage of cheddar cheese in processed products. Strong stocks are forecast to result in a marginal decline of total cheese production in 2013. Total cheese production in 2014 is forecast at 545 TMT.

Butter

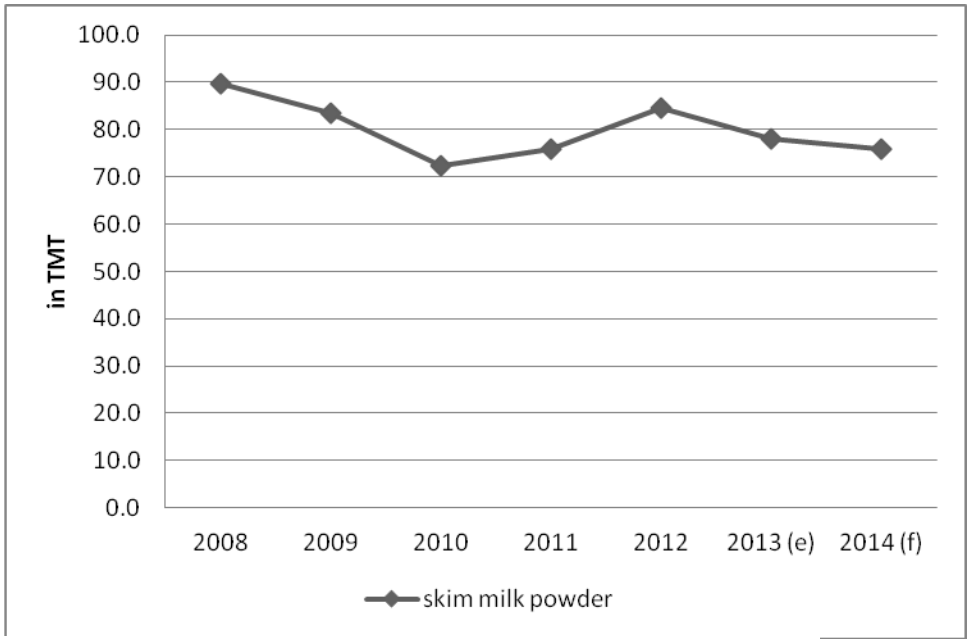
Figure 4: Butter Production in Canada, 2008-2014(f)

Source: Statistics Canada, Production of selected butter products, http://www5.statcan.gc.ca/cansim/pick-choisir?lang=eng&p2=33&id=0030009

After climbing to a production level of 98.0 TMT in 2012, the highest production level since 1990, total butter production is expected to fall to 92.0 TMT in 2013, and is forecast to fall to more average production levels of 88 MT in 2014. The production increase in 2012 was due to the need to rebuild low stocks due to production lagging behind the quota. In 2013, butter production is expected to remain higher than average due to milk production exceeding industrial requirements. Butter production has declined from a high of 99,426 MT in 1990 to a low of 75,832 MT in 2002 to a new low of 75,406 MT in 2006. Between 2002 and 2012, butter production rebounded due to the increasing demand for butter for pastries and other baked products.

Non-Fat Dry Milk (Skim Milk Powder)

Figure 5: Skim Milk Powder Production in Canada, 2008-2014(f)



Source: Statistics Canada, Supply and disposition of milk products in Canada, http://www5.statcan.gc.ca/cansim/pick-choisir?lang=eng&p2=33&id=0030007

Based on 8 months of production data, and the expected decrease in butter production compared to year 2012 levels, post estimates 2013 skim milk powder production to fall to 78 TMT from 85 TMT in 2012. Skim milk powder production drops further to 76 TMT in 2014 as a result of a forecasted continued slowdown in butter production.

Product Line Trends

Faced with increased competition and rapid advances in technology, the dairy industry has had to adapt to remain competitive and find new opportunities. The Canadian dairy industry has responded with the development of a robust line of dairy products, including probiotic yogurts, ultra filtered milk, and dairy products containing Omega-3 fatty acids. There are also over 665 varieties of cheese made in Canada.

While representing about one percent of total dairy output, organic milk production is steadily increasing in Canada, reaching close to 93.7 million liters in the 2010/2011 dairy year, up 4 percent from the previous year. The number of farms producing organic milk increased from 65 in 2000-2001 to 218 in 2011-2012. The most popular finished organic dairy products remain yogurt, ice-cream and cheese.

Prices

In February 2013, the Canadian Dairy Commission announced its decision to increase the support prices for butter and skim milk powder, effective April 1, 2013. The support price for skim milk powder increased to $6.4170 per kilogram and the support price for butter increased to $7.3379 per kilogram.

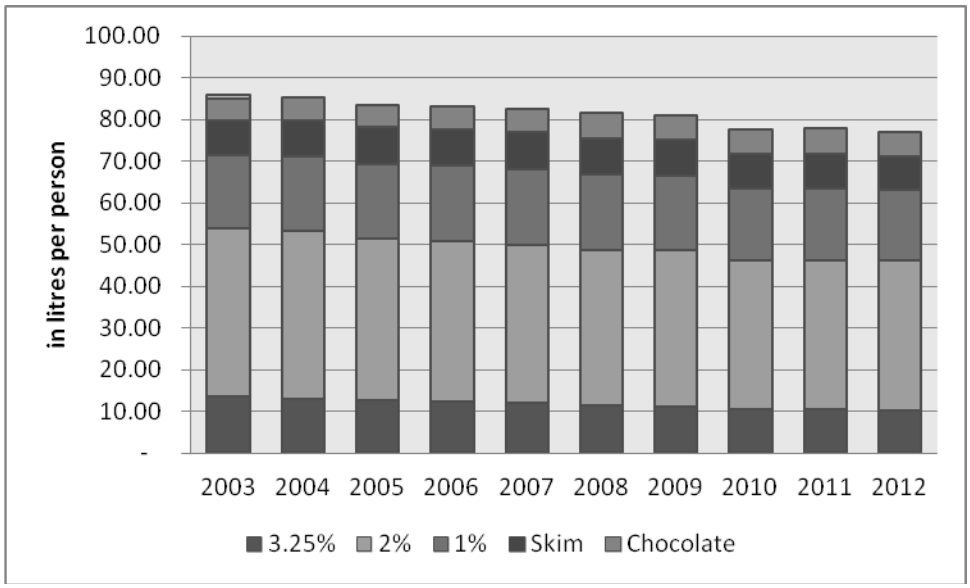
For Canadian dairy producers, this translates into a 0.9% revenue increase for industrial milk. In a Canadian Dairy Commission press release, a spokesperson for the CDC stated that the change in support prices reflected the increase in the cost of inputs, in particular the cost of feed, but that it remains lower than the rate of inflation for food which was at 2.4%.

Consumption:

Per Capita Consumption of Dairy Products

Milk

Figure 6: Per Capita Consumption of Milk, 2003-2012



Source: Canadian Dairy Information Center, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=cons&s3=conscdn

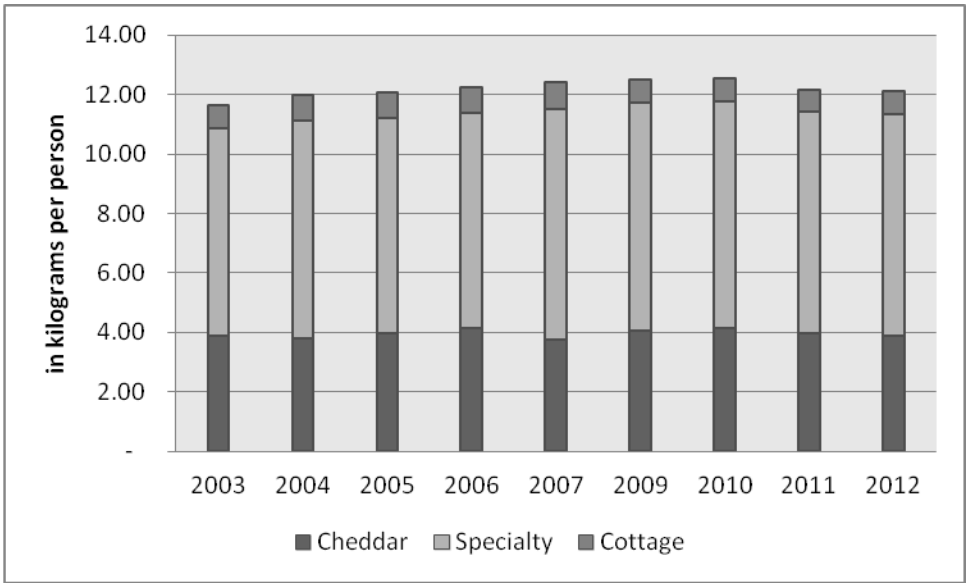
According to data compiled by Agriculture and Agri-Food Canada's Dairy Section, per-capita milk consumption (calculated by dividing annual fluid milk sales of standard, two percent, one percent, skim and chocolate milk by the Canadian population) fell to its lowest level of consumption in 2012. Per capita milk consumption has fallen from a high of 90.79 in 1994 to a low of 76.93 liters per person in 2012. Consumption across all categories decreased or remained the same, with skim milk showing the greatest decrease of 4% over the previous year's level.

This long term trend points to a decreased consumption per capita. In addition to higher prices, Canada's changing demographics and the availability of other calcium-fortified beverages such as soy beverages, has reduced consumer demand for milk. Immigration is responsible for the population growth in Canada and milk drinking often is not part of new Canadians' cultural eating patterns. This has a negative impact on total milk consumption which has fallen nearly 10% over the past 10 years. Conflicting health messages regarding the consumption of milk has also led to the increased popularity

of new beverage such as soy beverages that compete with milk. The dairy industry has tried to counter this with the promotion of milk as an alternative to sugary fruit and soft drinks and as a way of combating obesity-related issues.

Cheese

Figure 7: Per Capita Consumption of Cheese, 2003-2012

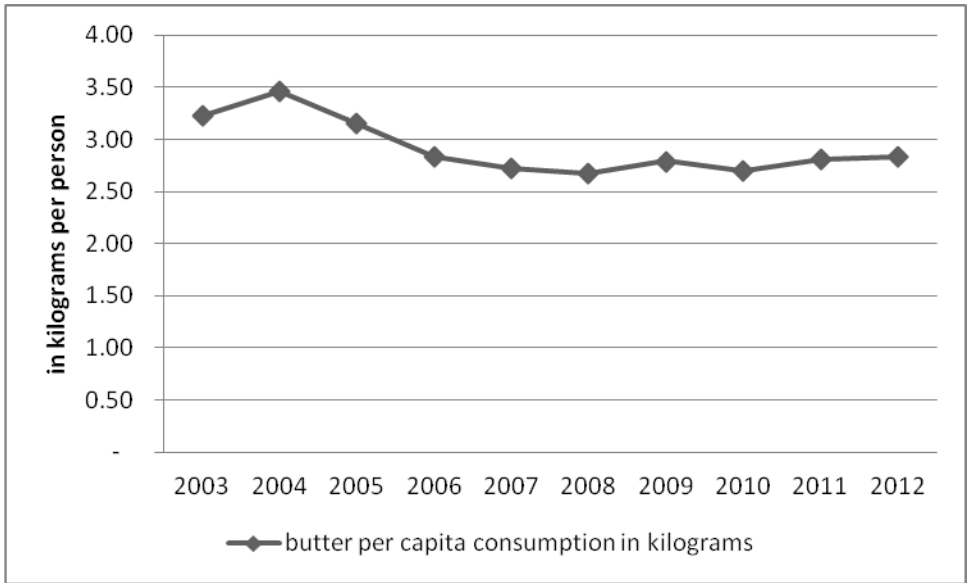


Source: Canadian Dairy Information Center, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=cons&s3=conscdn

According to the data compiled by Agriculture Canada's Dairy Section, in 2012, per capita domestic cheese consumption fell slightly or remained the same across all cheese categories (cheese, specialty, cottage). Per capita cheese consumption fell from 12.16 kilograms per person in 2011 to 12.09 kilograms per person in 2012. In recent years, per capita cheese consumption has been growing incrementally, due in part to increase usage of cheddar cheese in processed products, as well as an increasing popularity of artisanal cheeses.

Butter

Figure 8: Per Capita Consumption of Butter, 2003-2012



Source: Canadian Dairy Information Center, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=cons&s3=conscdn

Data compiled by Agriculture Canada's Dairy Section for 2012, reveals that per-capita butter consumption increased marginal from 2011 levels to 2.83 kilogram per person. A general downward trend since 2004 is reflective of high cost and increasing competition from liquid oils due to consumers demanding lower-fat alternatives to traditional products. The marginal increases in butter consumption in 2011 and 2012 are reflective of increased use of butter as an industrial input for products that are consumed in Canada, and an increase in demand for butter under the Import for Re-Export Program (IREP) for use in further processing.

Skim Milk Powder

Domestic consumption of skim milk powder decreased slightly in 2012, to 69 TMT from 74 TMT. The Canadian Dairy Commission has been working hard to develop new uses and markets for the surplus powder. The Dairy Marketing Program was expanded in 2004-2005 into the area of innovation. The program's main objectives are to promote awareness and increase utilization of dairy products and components by food product manufacturers; this includes finding new and innovative uses for skim milk powder in dairy and food products. The milk produced in Canada is sold to processors through a Harmonized Milk Classification System for the manufacture of products. The products are broken into five classes. The creation of a new milk class that encourages the use of skim milk powder approximately priced at the international price level has also aided in the utilization and reduction of the surplus skim milk powder. The utilization of skim milk powder in animal feed is an additional outlet that is aggressively being pursued. Although the general trend is upwards, domestic consumption of skim milk powder is expected to fall four percent in 2012. Skim milk powder faces limited competition from imports, due to a tariff rate quota (TRQ) on milk protein concentrates that has capped imports. The tariff rate quota for milk protein concentrate is not applicable to countries with which Canada has a free trade agreement.

Utilization of Milk and the Harmonized Milk Classification System

The Canadian Dairy Commission publishes the milk utilization by class (on a dairy year basis, August1 – July 31). The price paid for milk by processors varies according to the milk class 1- 5. For dairy year 2011-2012, on the standard basis of butterfat content (3.6 kg/hectolitre), 29.4 percent of all the milk produced in Canada was transformed into fluid milk, cream, and milk beverages, 7.8 percent into ice cream, sour cream, and other frozen dairy products, 33.6 percent into cheese, 20.5 percent into butter, milk components and concentrated milks, and 8.6 percent into further processed products destined for the domestic and export markets. More information on the Harmonized Milk classification System is available at the following website: http://www.cdc-ccl.gc.ca/CDC/index-eng.php?id=3811

Table 1: Milk Utilization by Class (Dairy Year)

Milk Class	Milk Utilization in Million HL		Percent of Total Milk		Percent Change
	2011/2012	2012/2013	2011/2012	2012/2013 (e)	
1	25.6	25.8	29.4	29.5	0.3%
2	6.8	7.0	7.9	8.0	1.9%
3(a), 3(b), 3(c), 3(d)	29.3	30.7	33.6	35.1	4.4%
4(a) and 4(a)1	16.5	14.1	18.9	16.1	-14.9%
4(b), 4(c), 4(d), 4(m)	1.3	1.1	1.5	1.2	-18.7%
5(a), 5(b), and 5(c)	7.2	7.6	8.3	8.7	5.2%
5(d)	0.2	1.1	0.3	1.2	336.4%
total	87.0	87.4			

Source: Canadian Dairy Information Center (http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=msp-lpl&s3=volume&page=volumes)

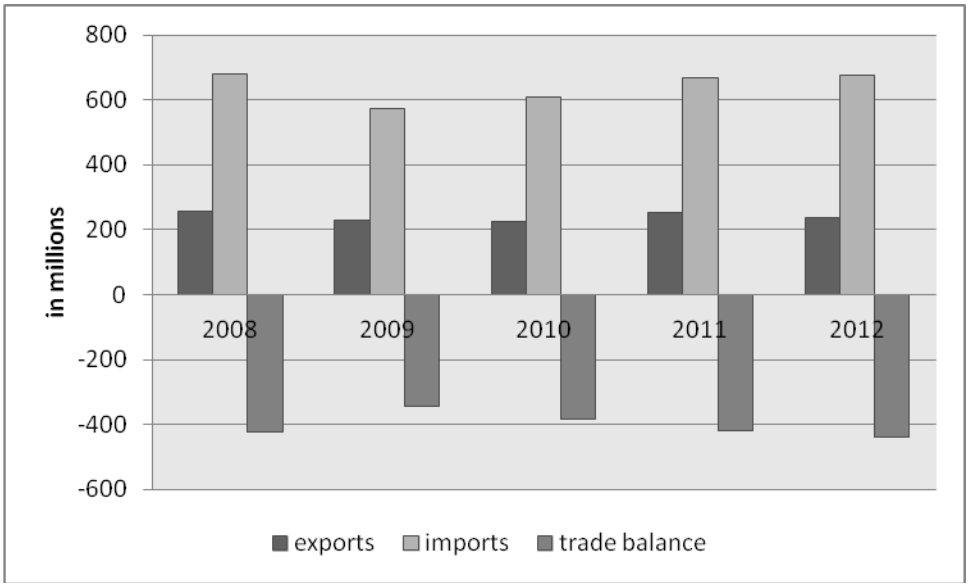
Summary of Harmonized Milk Classification System:
1: Milk or milk beverages, cream and other fluid products
2: Ice cream, sour cream, other frozen dairy products
3: Cheese
4: Butter, milk components, concentrated milks
5: Cheese and other dairy products used as ingredients.
Full descriptions available: Canadian Dairy Information Center

In the spring of 2013, amendments were made to the Harmonized Milk Classification System by breaking out class 3 (cheese) into four categories whereas previously there were only 2. Previously, all cheese was grouped into class 3(a) with the exception of cheddar which fell into class 3(b). The amendments now make a distinction between class(b) cheeses (Mozzarella, Asiago, Brick, Canadian style Munster), Colby, Farmer, Feta, Gouda, Havarti, Jack, Monterey Jack, Parmesan and Swiss) which are manufactured in Canada, class(c) cheese (all types of cheddar, remains the same as before the amendments) and class(d) cheese (a new class developed specifically for the restaurant trade), and class (a) cheese which is everything not in (b),(c), or (d). The new cheese class(d) is for mozzarella cheese and provides a price discount to dairy processers to produce a cheaper mozzarella to be used by restaurants in making fresh pizza. Arguing that frozen pizzas from grocery stores are directly competitive with fresh pizzas in restaurants, the Canadian Restaurant and Foodservices Association (CRFA) has been requesting for years that a new class of milk be created to allow for the production of

a cheaper mozzarella to be used in restaurants on fresh pizzas. Further processors, producing frozen pizzas for sale in grocery stores, have had access to cheaper mozzarella via a special class of milk since the mid 1990s (class 5(a)). The price differential between the new cheese class and the cheese available to further processors who manufacture frozen pizzas remains significant.

Trade:

Figure 9: Dairy Trade Balance for 2012



Source: Canadian Dairy Information Center, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=imp-exp&s3=bal

The 2002 ruling by the World Trade Organization (WTO) capped subsidized exports of dairy products from Canada. As a result, Canadian dairy producers are limited in the quantity of dairy products that can be exported from Canada and this has resulted in a negative trade balance in dairy products. For 2012, the Canadian dairy trade balance remained at a deficit of $C440 million.

Export and Import Controls for Dairy Products

Quantitative restrictions in ten categories of dairy products were converted to TRQs to support supply management of industrial milk under the Canadian Dairy Commission Act and as a result of the agreement at the World Trade Organization (WTO) in 1994.

Regulations for Imports and Exports of Dairy Products

Tariff Rate Utilization Tables and Quota holders for various dairy products in Canada:

http://www.international.gc.ca/trade/eicb/agric/milk-en.asp

Export and Import Permits Act:

http://laws.justice.gc.ca/en/E-19/index.html

Table 2: Tariff-Rate Quotas for Dairy Imports into Canada

Dairy Product Description	Access in tons	Tariff Item Number (to 6-digit)
Milk Protein Substitutes	10,000	0350.40 **
Fluid Milk[1]	0	0401.10, 0401.20
Cream, not concentrated, no sugar, (heavy cream)	394	401.30
Skim Milk Powder	0	0402.10.10
Whole Milk Powder, whether or not Sweetened	0	0402.21, 0402.29
Concentrated and Evaporated milk	12	0402.91, 0402.99
Yogurt	332	0403.10
Powdered Buttermilk	908	0403.90
Liquid Buttermilk, Sour Cream	0	0403.90
Dry Whey	3,198	0404.10
Products consisting of natural milk Constituents	4,345	0404.90
Butter, fats and oil from milk	3,274	0405.10, 0405.90
Dairy Spreads	0	0405.20
Cheese	20,412	0406
Ice cream mixes	0	1806.20, 1806.90
Ice Cream and other edible ice	484	2105
Milk cream and butter subs.	0	2106.90
Non-alcoholic beverages containing milk	0	2202.90
Complete feeds and feed supplements	0	2309.90

[1] There is no commercial TRQ for fluid milk. However access of 64,500 tons of fluid milk is allowed and considered filled by cross-border shopping.
** not applicable against countries with which Canada has a FTA

Import for Re-export Program (IREP)

Imports of dairy products/ingredients to be sold on the Canadian market are limited through import quotas and prohibitively high over-access tariffs. Canadian processors can, however, import certain dairy products/ingredients for use in the manufacturing of goods destined for export (for example pastries and confectionary items, cheeses, butter) through a program administered by International Trade Canada called the Import for Re-Export Program (IREP). Due to the fact that these goods are exported, they do not compete with domestic dairy ingredients. The advantage to Canadian exporters is

that they do not suffer a competitive disadvantage as they have access to dairy products/ingredients at world price. The Import for Re-export Program has grown in popularity since its creation in 2003 and is expected to continue growing in popularity due the accessibility afforded to food processors under the program.

The popularity of this program highlights the growing importance of the dairy ingredient market in further processing. It is the key to growing the dairy industry in developed markets where dairy consumption has reached maturity. The Canadian dairy industry has in place a number of programs that compete with the IREP program in an attempt to capture this dairy ingredients market. One such program is the Special Milk Class Permit Program (class 5 of the classified dairy pricing system). The Special Milk Class Permit Program (SMCPP) was created by the Canadian Milk Supply Management Committee (CMSMC) in 1995 and is run by the Canadian Dairy Commission (CDC). The program objective is to provide eligible further processors, distributors, and animal feed manufacturers with the means to access Canadian manufactured dairy ingredients, at prices that will allow them to remain competitive in the marketplace. The prices in this class are based on U.S. prices. Therefore, when U.S. prices get closer to world prices, the incentive to use IREP should decrease. More details on the special class program can be found at the following web address: http://www.milkingredients.ca/index-eng.php?id=119.

Other programs that have been used to foster the use of dairy ingredients by food processors include the CDC's Matching Investment Fund (MIF) which in mid-2009 replaced the Innovation Support Fund and the Direction Access Fund, and the Domestic Dairy Product Innovation Program.

Import for re-export trade is also highly influenced by what percentage of the total ingredients the imported good makes up in the product that must eventually be exported, as well as the strength of the Canadian dollar which effects Canada's export opportunities. As a result, while IREP popularity has been shown to grow over time, demand for IREP products can fluctuate from year to year.

According to Agriculture and Agri-Food Canada, in 2012, the value of imports for all dairy products increased by 1% over 2011 levels to reach $US 677 million. The volume of total imports of butter, milk, cream, skim milk powder and cheese decreased 2.5% below 2011 levels of 76.5 TMT and fell to 74.6 TMT. However, imports of these products under IREP increased slightly over year 2011 levels to reach 49.3 TMT. This represents a 66% share and a 3% share increase over 2011 levels. In 2012, imports for all dairy products under the IREP increased by 2% to 55.6 TMT, driven by lower world prices. Imports are expected to follow similar trends in 2013 and 2014.

Imports of Fluid Milk, Cheese, Butter, Skim Milk Powder

There are two available sources of Canadian import data for dairy products. Post has chosen to use data supplied by the Department of Foreign Affairs and International Trade (DFAIT) over the data supplied by Statistics Canada in order to minimize the risk of double counting. DFAIT is responsible for maintaining Canada's imports controls for the supply managed products.

Fluid Milk

The fluid milk access level is set at 64,500 MT, however there is no commercial quota available for fluid milk. It is assumed to be filled through cross border shopping. Fluid milk is imported under General Import Permit No. 1 - Dairy Products for Personal Use. Small amounts of fluid milk are also imported under supplemental permits issued by International Canada (IT), and through the IREP which accounts for nearly 100 percent of milk imports. Cream, unlike fluid milk, has a small commercial quota, which is determined on a dairy year (August-July) basis rather than an annual calendar year (CY) basis. The cream access level is 394 MT. Cream imports continue to increase due to the increased usage of the Import for Re-Export Program.

Total milk and cream imports in 2012, including IREP, supplemental permits, and imports under the Duty Deferral Program, reached 39 TMT, the same level reached in 2011. The popularity of IREP milk is likely to continue to drive milk imports and Post forecasts total milk imports in 2013 an 2014 to remain at similar levels.

Due to market proximity and the perishable nature of fluid milk and cream, the United States is the primary source for imports of milk and cream into Canada.

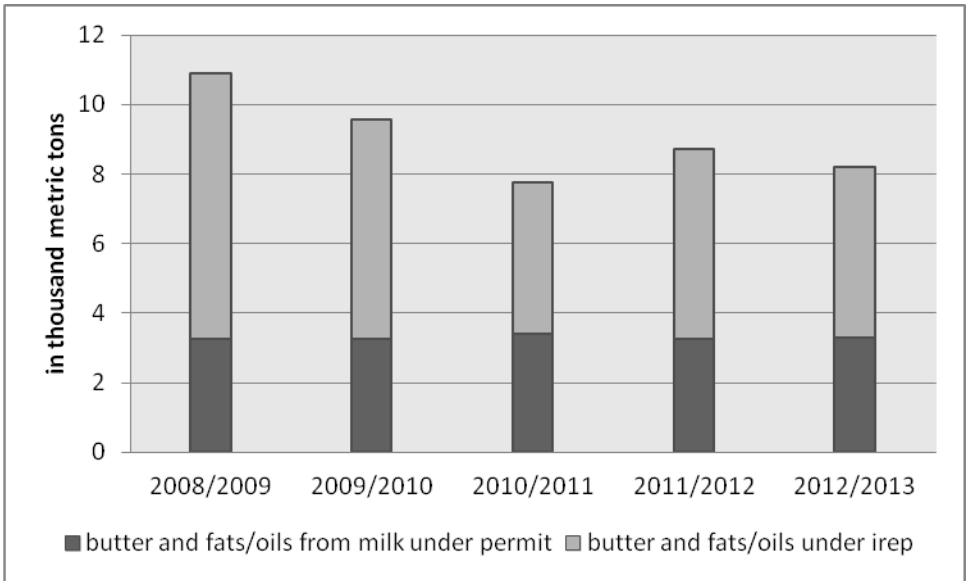
Cheese

In 2012, cheese represented close to 40 percent of all dairy imports. The commercial quota on cheese is 20,411,866 kilograms, and 66 percent of that cheese quota is specifically allocated to the European Union. Total cheese imports for 2012, were 26 TMT, with IREP trade accounting for approximately 12%. Since import levels tend to stay stable due to the TRQ in place, Post predicts a similar level of cheese imports for 2013 and 2014. Due to the country specific access, the EU-27 remains the largest cheese (excluding fresh cheeses) supplier to Canada.

Butter

Total butter imports are comprised of three HS codes: 0405.10.00 for butter, 0405.90.00 for fats and oils derived from milk, and HS 0405.20.00 (zero TRQ access) for dairy spreads, which contain butter. Similar to cream imports, the butter import access level is determined based on the dairy year, rather than the calendar year. The access quota is set at 3,274 MT and applies only to the butter and fats and oils from milk. Nearly two thirds of the TRQ is allocated to New Zealand (2,000 MT). Based on 8 months of trade data, total imports in 2013 are expected to remain close to year 2012 levels of 7 TMT. Imports are forecast to lift slightly in 2014 to 8 TMT.

Figure 10: Butter and Milk Derived Oils Imports under the IREP Program, 2008-2013 (Dairy Year Basis)

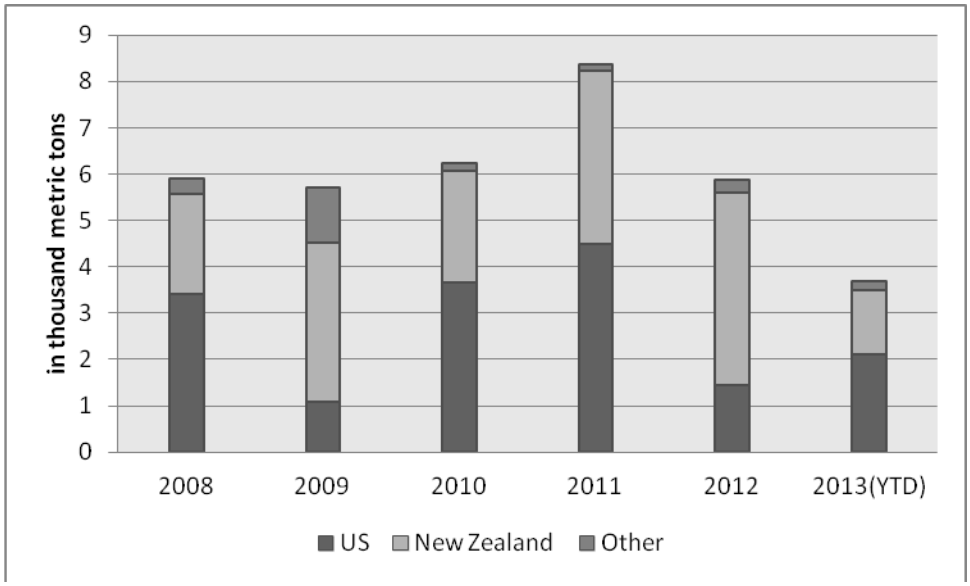


Source: Canadian Dairy Information Center; http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil#trade

Due to the TRQs in place on butter, the variability in butter and butter fats imports occurs around the import for re-export trade which is a function of the Canadian dollar. Over the last five years, IREP trade has accounted for between 57% and 70% of the imports under line 040590 and 040510. Figure is based on a dairy year (August 1- July 31) in order to give an accurate picture of IREP trade.

Due to its proximity to the Canadian market and the popularity of the import for re-export program, US butter imports (040510) account for between 25% and 59% of butter imports into Canada. Year to date data suggests that U.S. imports of butter in 2013 will increase over the previous year's level (**see figure 11 on next page**). This is likely due to competitive butter prices in the United States resulting from high domestic butter stocks combined with a strong Canadian dollar.

Figure 11: Imports of Butter by Country of Origin, 2008-2013



Source: Canadian Dairy Information Center; http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil#trade

Non-fat Dry Milk (Skim Milk Powder)

Due to the fact that there is no commercial quota on skim milk powder, almost all trade on skim milk powder takes place under the IREP (85.8% in 2012). In 2012, imports were 2.7 TMT and are forecast to remain steady in 2013 and 2014. These import levels are reflective of the attractive domestic programs that lead to low demand for non-fat dry milk under the IREP.

Exports of Fluid Milk, Cheese, Butter, Skim Milk Powder

The 2002 ruling by the World Trade Organization (WTO) capped subsidized exports of dairy products from Canada. As a result, Canadian dairy producers are limited in the quantity of dairy products that can be exported from Canada and this has resulted in a negative trade balance in dairy products. As the difference between Canada's domestic support prices and world prices increase, the amount that Canada can export within the WTO limits decreases.

In 2012, Canadian dairy exports showed a 6 percent annual decrease to C$237.4 million. The main products exported by Canada in 2012 were cheese, ice cream, whey, and skim milk powder. These represent 19.3 percent, 16.3 percent, and 13.9 percent respectively, share of total exports (value basis).

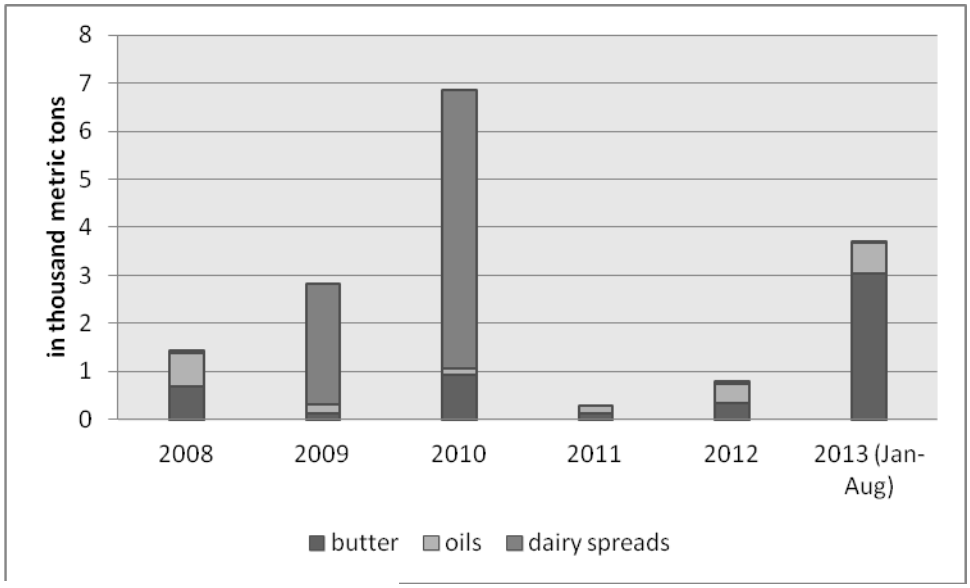
Fluid milk and cream exports in 2012 are reported to be 5.0 TMT. In 2013, based on year-to-date trade data through July, fluid milk and cream exports are expected to decrease to 3.5 TMT. Relatively the same level of supply in 2014 is forecast to keep fluid milk and cream exports at expected year 2013 levels.

The volume of total cheese exports in 2012 rose to 9.7 TMT from 8.8 TMT in 2011. This represents a 10% increase from 2012 levels. Eight months of trade data suggests that total cheese export may reach 10.0 TMT in 2013. Exports are forecast to remain close to these levels in 2014. In 2012, the United States and Saudi Arabia remained the two primary markets for Canadian cheese, accounting for 45

percent and 23 percent of cheese (excluding cream and fresh cheeses) exports, respectively. Canada has specific market access for 1,211 MT in the U.K. markets and has specific quotas for U.S. cheese markets for cheeses: swiss and emmental-type cheeses, and non-specified cheeses.

Total butter exports are comprised of three HS codes: 0405.10.00 for butter, 0405.90.00 for fats and oils from milk, and 0405.20.00 for dairy spreads, which contain butter. Total butter exports in 2013 will increase significantly over 2012 levels due mainly to a need to get rid of surplus butter in the system. As of the end of August 2013, butter exports had reached 3.342 TMT, a level of butter exports not seen since 2006 when the butter exports for the year reached 3.696 TMT. This level of export is still within WTO allowable limits. The 2002 ruling by the World Trade Organization (WTO) capped subsidized exports of butter from Canada at 3.5 TMT (dairy year/marketing year basis). Canada is also still respecting its outlay commitment level of $US 31 million dollars. Butter exports under HS code 040510 are headed to Turkey, Egypt and Morocco. Total butter exports (04051000, 040590, and 040520) for calendar year 2013 are expected to reach 5 TMT in 2013 and then fall to 3 TMT as butter production slows, and there is less surplus butter in the system.

Figure 12: Total Exports of Butter, Milk Derived Fats/Oils and Dairy Spreads, 2008-2013



Source: Canadian Dairy Information Center; http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil#trade

The 2002 WTO ruling capped Canada's exports of SMP at 44,953 MT, limiting the ability of the industry to reduce the structural surplus of SMP that is inherent in an industry where the quota system is based on butterfat. In 2012, high supplies and strong demand pushed SMP exports to 10.4 TMT. Year to date data suggests that this trend will continue in 2013. Skim milk powder exports are forecast to come down slightly in 2014.

Stocks:

In order to ensure that supply management operates as it is designed, and the Canadian market has a constant supply of product, the Canadian Dairy Commission (CDC) holds stocks of butter in storage throughout the year. This is referred to as the normal butter inventories of 12,000 MT.

Dairy Policy Developments:

Comprehensive Economic Trade Agreement (CETA)

On October 18, 2013, Canada announced that it had reached an agreement in principle with the European Union. The Canada-European Union (EU) trade agreement is being described as going far beyond the North American Free Trade Agreement (NAFTA). The EU has been granted concessions on dairy that will allow the EU even greater cheese access into the Canadian market (expanding of the cheese quota and elimination of in-quota tariffs). The preferential quota access is being expanded to nearly 32 TMT from 13.5 TMT, and the over-quota tariff on the milk protein concentrate (35.04.00.12) is being eliminated completely. Included in the 32 TMT is 800 tons of the global cheese quota which is being granted to the EU to account for the expansion of the EU. The cheese access accounts for approximately 4.2% of domestic cheese consumption. A list of products with geographical indications has been agreed to and Canada is said to have protected all current producers. Canada has also made assurances that the products affected by geographical indications will not have an impact on other free trade agreements. Reactions to news of the deal have been positive for the most part. The provinces, which may need to amend their provincial regulations in order to comply with the trade agreement, have declared their support for the agreement in principle, but Quebec and Ontario are demanding that compensation be given to those in dairy that are affected by the additional access. The government has stated that it will provide compensation to the extent that the industry will suffer injury but feel that the additional access will have a small impact since, by their calculations, the domestic cheese markets has been growing by 6,000 tons a year. The Liberal Party of Canada, which has been a defender of the supply management sector of long standing, issued a news release congratulating all those involved in the effort of finalizing the deal and stated that the party is broadly supportive of the CETA. The Dairy Farmers of Canada lobby group released a press release expressing their displeasure that dairy has not been left off the table. The New Democratic Party of Canada (official opposition party at the federal level) sided with the Dairy Farmers of Canada lobby organization. Other export oriented lobby organizations issued press releases in support of the deal.

Geographical Indications

With the Canada / European Union finishing up the last details of the agreement, how Canada will address, implement, and enforce the products covered by geographical indications is still not known. The list includes a number of cheeses, a few of which are matters of significant concern to the Canadian dairy industry. From a trade perspective, the concern is that the geographic indications provisions will diminish export opportunities, and set a precedent for other FTAs.

Special Milk Classes, Domestic Support and Export Subsidies

The newly announced Canada-EU free trade agreement, a potential Trans-Pacific Partnership deal, and recent changes to the Harmonized Milk Classification System, may put additional focus on the way Canada provides and calculates domestic support and export subsidies for its dairy programs. The practice (calculation at the primary production level but not for each class) has long been questioned at the WTO in the Committee on Agriculture. This type of methodology may come under greater pressure if changes to the classification system and application of the special classes are used increasingly as ways to mitigate the demand for imports, while at the same time not being captured in the calculation of export subsidies.

Ice Cream Promotion Program

In March 2009, Canada instituted a new program for ice cream manufacturers that provides a discount on the price of milk/cream purchased to make ice cream. This discounted milk/cream is only available for ice cream that is to be manufactured using 100 percent Canadian dairy ingredients. This is part of a broader promotional program that grants diary product manufacturers who use only Canadian dairy ingredients to enter into a licensing agreement for use of the "little blue cow" logo. The discounted milk/cream for use in qualifying ice cream program is designed to render imports of butter/oil/sugar blends and domestically produced vegetable oils less competitive for use in ice cream and ice cream products.

The "little blue cow" logo is also finding increasing popularity with cheese dairy processors. Many of the smaller cheese manufacturers are using the little blue cow logo. Loblaw's, one of the three largest supermarket chains in Canada, is also using the logo on its "store brand" cheese.

However, the program is not without opposition, and continues to be questioned by other countries at the Agriculture Committee meeting of WTO members. New Zealand once again questioned the pooled returns and shared promotion costs of the Ice Cream Promotion Program. Canada's view on this is that this is a private confidential contractual agreement between an NGO (the Dairy Farmers of Canada) and individual ice cream processors, without any support from the government's Canadian Dairy Commission.

Supply Management

Canada's supply management system continues to come under pressure due to increasing pressure from trade partners, a positive market environment, and the general movement towards freer markets. The conclusion of the CETA may foreshadow Canada's willingness to open more of its supply managed industries as it continues to engage in the negotiations of the Trans-Pacific Partnership (TPP) which is scheduled to be concluded by the end of the year.

Statistics:

Dairy, Milk, Fluid Canada	2012	2013	2014
	Market Year Begin: Jan 2012	Market Year Begin: Jan 2013	Market Year Begin: Jan 2014

	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Cows In Milk	985	960	985	961		960
Cows Milk Production	8,450	8,614	8,500	8,535		8,350
Other Milk Production	0	0	0	0		0
Total Production	8,450	8,614	8,500	8,535		8,350
Other Imports	40	34	40	40		40
Total Imports	40	34	0	40		40
Total Supply	8,490	8,648	8,540	8,575		8,390
Other Exports	3	5	3	4		4
Total Exports	3	5	3	4		4
Fluid Use Dom. Consum.	3,200	3,040	3,250	3,014		3,000
Factory Use Consum.	4,892	5,193	4,892	5,151		5,036
Feed Use Dom. Consum.	395	410	395	406		350
Total Dom. Consumption	8,487	8,643	8,537	8,571		8,386
Total Distribution	8,490	8,648	8,540	8,575		8,390
1000 HEAD, 1000 MT						

Dairy, Cheese Canada	2012		2013		2014	
	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013		Market Year Begin: Jan 2014	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	45	45	45	72		77
Production *	304	549	304	550		545
Other Imports	25	25	25	25		25
Total Imports	25	25	25	25		25
Total Supply	374	644	374	647		647
Other Exports	9	10	9	10		9
Total Exports	9	10	9	10		9
Human Dom. Consumption	320	562	320	560		560
Other Use, Losses	0	0	0	0		0
Total Dom. Consumption	320	562	320	560		560
Total Use	329	572	329	570		569
Ending Stocks	45	72	45	77		78
Total Distribution	374	644	374	647		647
1000 MT						

*Significant increase in production between "USDA Official" and "New Post" for 2012 and 2013 is due to change in methodology which is to include "speciality cheeses" in production numbers.

Dairy, Butter Canada	2012		2013		2014	
	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013		Market Year Begin: Jan 2014	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	12	9	16	17		16
Production	93	98	88	92		88
Other Imports	7	7	7	7		8
Total Imports	7	7	7	7		8
Total Supply	112	114	111	116		112
Other Exports	0	0	1	5		3
Total Exports	0	0	1	5		3
Domestic Consumption	96	97	97	95		95
Total Use	96	97	98	100		98
Ending Stocks	16	17	13	16		14
Total Distribution	112	114	111	116		112
1000 MT						

Dairy, Milk, Nonfat Dry Canada	2012		2013		2014	
	Market Year Begin: Jan 2012		Market Year Begin: Jan 2013		Market Year Begin: Jan 2014	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	25	23	27	31		30
Production	86	85	82	78		76
Other Imports	3	3	2	3		2
Total Imports	3	3	2	3		2
Total Supply	114	111	111	112		108
Other Exports	10	10	10	11		10
Total Exports	10	10	10	11		10
Human Dom. Consumption	76	69	71	70		70
Other Use, Losses	1	1	1	1		1
Total Dom. Consumption	77	70	72	71		71
Total Use	87	80	82	82		81
Ending Stocks	27	31	29	30		27
Total Distribution	114	111	111	112		108
1000 MT						